# 89-1614

Supreme Court, U.S.
FILED
APR 17 1990
JOSEPH F. SPANIOL, JR.
CLERK

No. ——

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1989

---

LOMBARD BROTHERS, INC.,
*Petitioner,*

v.

UNITED STATES OF AMERICA,
*Respondent.*

---

**PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT**

---

ANDREW B. BOWMAN
1804 Post Road East
Westport, CT 06880
(203) 259-0599
*Counsel of Record for Petitioner*

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

## QUESTION PRESENTED

Whether Rule 52(a) of the Federal Rules of Civil Procedure permits the Court of Appeals to disregard the District Court's findings of fact and to substitute its own factual findings thereby reversing the District Court's factual finding that petitioner had sustained a $1.77 million dollar theft loss within the meaning of § 165 of the Internal Revenue Code of 1954 and the Connecticut larceny statute where the District Court's findings were not clearly erroneous.

## RULE 29.1 LIST OF PARTIES

In addition to the named petitioner, Lombard Brothers, Inc., other parties who will be bound by the judgment in the court below are as follows:

1. North Penn Transfer, Inc. of Lansdale, Pennsylvania.

2. Anders Holding Company of Lansdale, Pennsylvania.

Petitioner Lombard Brothers, Inc., is a subsidiary of these two corporations.

## TABLE OF CONTENTS

TABLE OF CONTENTS—Continued

## TABLE OF AUTHORITIES

*CASES:* Page



*STATUTES:*

IN THE
# Supreme Court of the United States
OCTOBER TERM, 1989

---

No. ———

---

LOMBARD BROTHERS, INC.,
*Petitioner,*
v.
UNITED STATES OF AMERICA,
*Respondent.*

---

**PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT**

---

Petitioner Lombard Brothers, Inc. respectfully prays that a writ of certiorari issue to review the judgment and decree of the United States Court of Appeals for the Second Circuit entered in the above-entitled matter on January 19, 1990 reversing the order of the United States District Court for the District of Connecticut entered on March 29, 1989 holding that petitioner was entitled to a deduction for a theft loss under § 165 of the Internal Revenue Code of 1954.

## OPINIONS BELOW

The opinion of the court of appeals in this matter is reported at 893 F.2d 520 and is reprinted in the Appendix to this petition (1a). The opinion of the United

States District Court for the District of Connecticut is unreported and is reprinted in the Appendix (12a).

## JURISDICTION

The judgment of the court of appeals was entered on January 19, 1990. The jurisdiction of this Court to review the judgment of the Second Circuit is invoked in accordance with 28 U.S.C. § 1254(1).

## STATUTORY PROVISIONS AND RULES INVOLVED

Title 26 United States Code, Section 165 provides:

Section 165 Losses.

(a) General rule.

There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

(b) Amount of deduction.

For purposes of subsection (a), the basis for determining the amount of the deduction for any loss shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property.

(e) Theft losses.

For purposes of subsection (a), any loss arising from theft shall be treated as sustained during the taxable year in which the taxpayer discovers such loss.

Title 28 Federal Rules of Civil Procedure *Rule 52 provides*:

RULE 52. FINDINGS BY THE COURT

(a) Effect. In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its

conclusions of law thereon, and judgment shall be entered pursuant to Rule 58; and in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. The findings of a master, to the extent that the court adopts them, shall be considered as the findings of the court. It will be sufficient if the findings of fact and conclusions of law are stated orally and recorded in open court following the close of the evidence or appear in an opinion or memorandum of decision filed by the court. Findings of fact and conclusions of law are unnecessary on decisions of motions under Rules 12 or 56 or any other motion except as provided in Rule 41(b).

Connecticut General Statutes—§ 53a-118. Definitions Generally:

(a) The following definitions are applicable to this part: (1) "Property" means any money, personal property, real property, thing in action, evidence of debt or contact, or article of value of any kind. Commodities of a public utility nature such as gas, electricity, steam and water constitute property, but the supplying of such a commodity to premises from an outside source by means of wires, pipes, conduits or other equipment shall be deemed a rendition of a service rather than a sale or delivery of property. (2) "Obtain" includes, but is not limited to, the bringing about of a transfer or purported transfer of property or of a legal interest therein whether to the obtainer or another. (3) To "deprive" another of property means (A) to withhold it or cause it to be withheld from him permanently or for so extended a period or under such circumstances that the major

portion of its economic value or benefit is lost to him, or (B) to dispose of the property in such a manner or under such circumstances as to render it unlikely that an owner will recover such property. (4) To "appropriate" property of another to oneself or a third person means (A) to exercise control over it, or to aid a third person to exercise control over it, permanently or for so extended a period or under such circumstances as to acquire the major portion of its economic value or benefit, or (B) to dispose of the property for the benefit of oneself or a third person. (5) An "owner" means any person who has a right to possession superior to that of a taker, obtainer or withholder. (6) To "receive" means to acquire possession control or title, or to lend on the security of the property. (7) "Service" includes, but is not limited to labor, professional service, public utility and transportation service, the supplying of hotel accommodations, restaurant services, entertainment, and the supplying of equipment for use. (8) "Check" means any check, draft or similar sight order for the payment of money which is not post-dated with respect to the time of issuance. (9) "Drawer" of a check means a person whose name appears thereon as the primary obligor, whether the actual signature be that of himself or of a person purportedly authorized to draw the check in his behalf. (10) "Representative drawer" means a person who signs a check as drawer in a representative capacity or as agent of the person whose name appears thereon as the principal drawer or obligor. (11) A person "issues" a check when, as a drawer or representative drawer thereof, he delivers it or causes it to be delivered to a person who thereby acquires a right against the drawer with respect to such check. One who draws a check with intent that it be so delivered is deemed to have issued it if the delivery occurs. (12) A person "passes" a check, when, being a payee, holder or bearer of a check which previously has been or purports to have been drawn and issued by another, he delivers it, for a

purpose other than collection, to a third person who thereby acquires a right with respect thereto. (13) "Funds" means money or credit. (14) A drawer has "insufficient funds" with a drawee to cover a check when he has no funds or account whatever, or funds in an amount less than that of the check; and a check dishonored for "no account" shall also be deemed to have been dishonored for "insufficient funds" (15) "Credit" means an arrangement or understanding with a bank or depository for the payment of a check, draft or order in full on presentation.

(b) A person who has obtained possession of property by theft or other illegal means shall be deemed to have a right of possession superior to that of a person who takes, obtains, or withholds it from him by larcenous means.

(c) A joint or common owner of property shall not be deemed to have a right of possession thereto superior to that of any other joint or common owner thereof.

(d) In the absence of a specific agreement to the contrary, a person in lawful possession of property shall be deemed to have a right of possession superior to that of a person having only a security interest therein, even if legal title lies with the holder of the security interest pursuant to a conditional sale contract or other security agreement.

Connecticut General Statutes § 53a—119, Larceny Defined:

A person commits larceny when, with intent to deprive another of property or to appropriate the same to himself or a third person, he wrongfully takes, obtains or withholds such property from an owner. Larceny includes, but is not limited to:

(1) Embezzlement. A person commits embezzlement when he wrongfully appropriates to himself or to another property of another in his care or custody.

(2) Obtaining property by false pretenses. A person obtains property by false promise when, by any false token, pretense or device, he obtains from another any property, with intent to defraud him or any other person.

(3) Obtaining property by false promise. A person obtains property by false promise when, pursuant to a scheme to defraud, he obtains property of another by means of representation, express or implied, that he or a third person will in the future engage in particular conduct, and when he does not intend to engage in such conduct or does not believe that the third person intends to engage in such conduct. In any prosecution for larceny based upon a false promise, the defendant's intention or belief that the promise would not be performed may not be established by or inferred from the fact alone that such promises was not performed.

(4) Acquiring property, lost, mislaid or delivered by mistake. A person who comes into control or property of another that he knows to have been lost, mislaid, or delivered under a mistake as to the nature or amount of the property or the identity of the recepient is guilty of larceny if, with purpose to deprive the owner thereof, he fails to take reasonable measures to restore the property to a person entitled to it.

(5) Extortion. A person obtains property by extortion when he compels or induces another person to deliver such property to himself or a third person by means of instilling in him a fear that, if the property is not so delivered, the actor or another will: (A) cause physical injury to some person in the future; or (B) cause damage to property; or (C) engage in other conduct constituting a crime; or (D) accuse some person of a crime or cause criminal charges to be instituted against him; or (E) expose a secret or publicize an asserted fact, whether true or false,

tending to subject some person to hatred, contempt or ridicule; or (F) cause a strike, boycott or other collective labor group action injurious to some person's business; except that such a threat shall not be deemed extortion when the property is demanded or received for the benefit of the group in whose interest the actor purports to act; or (G) testify or provide information or withhold testimony or information with respect to another's legal claim or defense; or (H) use or abuse his position as a public servant by performing some act within or related to his official duties, or by failing or refusing to perform an official duty, in such manner as to affect some person adversely; or (I) inflict any other harm which would not benefit the actor.

## STATEMENT OF THE CASE

***The Nature of the Proceedings:***

Petitioner Lombard Brothers, Inc. filed this action seeking partial refunds of taxes paid during the years 1976 and 1977. Petitioner's theory of recovery is predicated upon 26 U.S.C. 165(a) & (e) which provide that a taxpayer victimized by theft may claim as a deduction the resulting loss which remains uncompensated by insurance. The district court, Honorable T.F. Gilroy Daly, conducted a two day bench trial on February 1 and February 2, 1989 at which trial all testimony and documentary evidence was submitted. On March 28, 1989 the district court issued a detailed memorandum of decision (12a) in which detailed findings of fact and conclusions of law were set forth. On March 29, 1989 judgment was entered in the district court allowing petitioner to deduct a theft loss discovered during the year 1978 and carried back to the years 1976 and 1977 in the amount of $1.77 million dollars.

On May 30, 1989 the respondent United States of America appealed the judgment of the district court to the United States Court of Appeals for the Second Circuit. On January 19, 1990 the Second Circuit reversed the judgment of the district court finding that the petitioner was not entitled to a deduction for a theft loss of funds, the loss of which the district court had found to be the result of larceny under the Connecticut larceny statute.

***Statement of Facts:***

Petitioner Lombard Brothers, Inc. is a Connecticut corporation which, during the events in question, operated its trucking business in Waterbury, Connecticut. In September, 1976 petitioner's treasurer, Anthony Lombard, who testified at trial, was solicited by a college acquaintance, George Quinion, Jr. to invest petitioner's surplus capital in a "cash management system" (12a). Quinion was president of General Asset Management Co., Inc. ("GAM"). On September 13, 1976, petitioner entered into a contract with GAM giving GAM the right to invest funds petitioner had deposited in a custodian account established at the direction of GAM. Pursuant to the contract, petitioner granted GAM "full authority . . . to make all decisions with respect to (i) the investment policies and (ii) the purchase, sale and retention of particular securities [ ]" with respect to funds deposited into the custodian account. The authority was limited, however, by certain language appended to the last page of the contract, which provided that the "[c]ontract [was] restricted to U.S. Government obligations only until further notice in writing". (13a).

Pursuant to this agreement, petitioner deposited the following amounts into a custodian account maintained at the Chemical Bank in New York:

| AMOUNT | DATE |
|---|---|
| $800,100.00 | September, 1976 |
| $850,000.00 | April, 1978 |
| $920,000.00 | May, 1978 |
| $150,000.00 | June, 1978 |
| $ 5,000.00 | July, 1978 |
| $133,000.00 | January, 1979 |
| $595,000.00 | February, 1979 |
| $ 18,794.12 | March, 1979 |

Petitioner received back from GAM the following amounts:

| AMOUNT | DATE |
|---|---|
| $254,000.00 | February, 1977 |
| $150,000.00 | October, 1977 |
| $100,000.00 | December, 1977 |
| $ 15,000.00 | June, 1978 |

During the four years in question, GAM obtained from petitioner a total of $3,471,894.12. From this sum, $2,952,894.12 was lost by GAM (13a). The district court found that Anthony Lombard had no investment experience and did not seek out any additional advice before getting Lombard's directors to approve the investment management contract with GAM. Anthony Lombard testified that GAM represented to him that it would invest petitioner's monies in safe government bonds to earn a return of ten percent. This understanding conforms, in part, with the annotation on the contract limiting GAM's investment authority (14a).

The district court found that although the return promised by GAM was higher than petitioner was receiving on its funds, Anthony Lombard believed that petitioner's investment with GAM was similar to investing in a certificate of deposit or a savings account and that the principal petitioner invested would not be put at risk (14a). The district court further found that petitioner's understanding "was deliberately fostered by

GAM" [a]s shown in GAM's March 14, 1977 letter to petitioner's bookkeeper which stated: "the risk of owning a treasury outright is that the U.S. Government declares bankruptcy. If this occurs, our worries will make any such loss irrelevant as our currency and circulation will be worthless anyway." (14a).

At petitioner's request, GAM sent monthly statements to petitioner regarding the status of its account and investments. The statements purported to set forth *inter alia*, the net book value of the securities owned by the petitioner, net book value of purchased interest, the cash balance of the account, the total book value of the account and the net gain (loss) and interest earned (lost) on transactions closed during the prior month. The monthly statements also disclosed that GAM was engaging in speculative trades known as repurchase agreements ("repos") reverse repos, "long" and "short" sales of securities. GAM appended to each monthly report a computerized listing of all the trades it made in petitioner's account during the prior month. (14a-15a)

GAM's former comptroller, Kenneth Stevenson, testified at trial that petitioner's account was unique, because the volume of trading therein was at least 10 times greater than the trading volume of any other GAM account. The district court found on the basis of Stevenson's testimony and documentary evidence submitted at trial that in 1977 petitioner had approximately $545,000.00 invested with GAM, yet GAM made daily trades ranging from $1 million to $2 million. (15a).

The district court found that petitioner did not recognize that something was "terribly amiss" (15a). Anthony Lombard testified that he only glanced at the monthly statements, if he saw them at all, and then forwarded them to his bookkeeper, Joseph Bartoli, so that the proper accounting entry concerning interest expenses and earnings could be made. The district court found that neither Bartoli nor Anthony Lombard under-

stood the significance of the data contained in the monthly reports because they lacked any training or experience in the buying or selling of government securities. (15a). Stevenson confirmed the district court's findings when he testified that after meeting with Bartoli and Anthony Lombard in early 1978, Stevenson concluded they had no understanding of the trading that was taking place and recommended to his GAM superiors that the petitioner be fully apprised of both the nature and status of the account. (15a). Petitioner relied on GAM's apparent good faith and honesty, and its representations concerning how its account would be managed and invested rather than invesitgating and inquiring about their account. (15a).

Based upon the testimony of Kenneth Stevenson who prepared the monthly reports, the district court found that Stevenson's monthly reports "were both deceptive and grossly inaccurate". (15a). The monthly reports "failed to accurately report the monthly losses plaintiff incurred in its investment accounts". (15a). GAM incurred *staggering* losses and then tried to hide them by waiting to offset them against future gains which never materialized. The district court then analyzed the evidence in the following respects. "For example, for January, 1977 GAM reported a monthly loss of $3,083.75 when in fact its trading strategy had caused the plaintiff to suffer losses of $108,474.38 in that month alone." The district court then found "[i]n doing this, GAM misrepresented the true running balance of Lombard's total losses". (16a).

The district court then found as a fact that by using false monthly reports through the month of May, 1978, petitioner "might have concluded that the running balance of its account was a net gain of $33,133.26 when in fact as of that time the account had net losses of $2,303,367.70". (16a). The district court found that the reports did not disclose that GAM had used petitioner's

money to invest on margin, that the reports misrepresented the book value of petitioner's account, nor did the reports reflect that in May, 1977, Lombard's account was entirely depleted. "Yet GAM reported its book value as $350,042.21. These findings were based upon Stevenson's testimony. 16a).

The district court found that prior to April 1978, petitioner's suspicions were not unduly aroused by GAM's activities (16a). However, in April 1978, the bottom fell out when GAM called Anthony Lombard with news of a margin call, demanding an additional $850,000.00 by mid-day and threatening that the failure to come up with the money could result in losses to Lombard ranging from $40-$60 million. Faced with this threat over the next two months, Lombard transferred $1,770,000 to its GAM investment account." (16a).

On April 19, 1978 petitioner sent written notice to GAM that it was terminating its account. Petitioner sought to recoup its losses after its transfer of $1.77 million by continuing to deal with William Jones who was GAM's primary money manager and trader. Petitioner continued to receive false monthly reports until July, 1978 when GAM notified Lombard in writing that it was "booking" losses in the amount of $2,301,895.25; it had finally decided to account for those losses realized but not yet reported to Lombard." (17a). After July, 1978 petitioner continued to deposit money, an additional $901,794.12, in the hope that "things would turn around". (17a). As the district court found, "they never did" and after an IRS audit in the spring of 1979, petitioner became aware of the magnitude of its losses and did not invest any additional funds. (17a).

Petitioner did not advise any law enforcement official that it believed it was a victim of theft or fraud. Rather, in the latter part of 1979, Lombard brought a civil action against GAM, its principals, various brokers and other parties. After a portion of that action was dis-

missed for lack of personal jurisdiction and after learning through discovery that GAM and its principals were judgment proof, Lombard elected not to proceed further with that civil remedy. (17a).

On its original 1978 federal income tax return, petitioner claimed a short-term "capital interest loss" of $1,965,610.14 attributable to the losses of funds caused by GAM securities trading. On September 5, 1979, petitioner filed an amended 1978 federal income tax return for 1978 claiming that it was entitled to an increase in its total ordinary deductions of $1,965,610.14. During this period of time documents were being analyzed by petitioner's accountants which were being provided during the year 1979 by Kenneth Stevenson which were introduced into evidence and which showed, trade by trade, just how the Lombard's funds were misused. (17a).

On July 16, 1981 petitioner filed amended federal income tax returns for 1976 and 1977 claiming refunds of taxes paid for those years due as a result of carrybacks of net operating losses alleged to have resulted from theft losses discovered in 1978. The respondent refused to classify these losses as ordinary losses resulting from theft and refused to issue a refund. Petitioner then brought this timely tax refund action in the United States District Court for the District of Connecticut on May 20, 1987.

The district court found that the initial $800,100 was wrongfully obtained by GAM from Lombard by falsely promising that it would prudently invest the funds in safe government securities, earn a return of ten percent and never jeopardize the principal investment. (20a). The district court found however that "GAM did not form the requisite specific intent to deprive or permanently retain the funds it obtained from Lombard" at that time. (20a). The district court found that GAM's false promises, made to induce Lombard to invest, "must be viewed separately from its intent to

use or to dispose of the investment fisc." (20a). The district court specifically found that although GAM intended to engage in speculation at that time, the district court was not compelled to conclude that at that time GAM inended to deprive Lombard of its initial investment. (20a). Therefore, as to the *initial* investment of $800,100, the district court found that there was no evidence that GAM intended to deprive and retain in some permanent fashion petitioner's initial investment, and therefore the crime of larceny under Connecticut law was not committed.

However, the district court found a theft to have occurred in April and May of 1978 when the petitioner, responding to a demand by GAM in the form of a margin call, gave to GAM another $1,770,000. (20a). The district court specifically found that the petitioner transferred the $1.77 million to GAM, because of "the threat communicated by GAM that if the margin call were not met petitioner faced losing from $40-$60 million. (20a). The district court found that GAM's false pretenses and devices, namely the monthly reports, prevented petitioner from recognizing that GAM had been borrowing in Lombard's name on margin to make up for the fact that it had lost all of Lombard's money. (20a-21a). The district court then found that "[i]n this instance, GAM wrongfully obtained Lombard's monies by misrepresenting both the existence and scope of prior losses and exaggerating the threat posed by the margin call. These funds were obtained without Lombard's knowing consent. Furthermore, GAM obtained these monies with the requisite intent to permanently deprive Lombard of them." (21a).

The district court then found that GAM had fabricated the extent of the margin call in order to induce Lombard to make additional transfers of funds and that, in effect, GAM had "appropriated Lombard's funds to its own use to cover up its own gross malfeasance and acted with complete knowledge that the funds would be

disposed of in such a manner that Lombard would never be able to recover them." (21a). The district court then found that "in this instance, GAM committed larceny. Therefore, Lombard is entitled to take a theft loss with respect to these funds." (21a).

In contrast, the district court found that funds invested by the petitioner during the following months of June and July, 1978 and January, February, March, 1979 in the amount of $901,794.12 were not funds obtained by larceny. At this point the district court found that "while Lombard may have not completely understod the entire magnitude of its losses up to this time, Anthony Lombard testified that he and the Board of Directors knew that there was a substantial risk associated with any further investments, and therefore the district court would not allow any further deduction for losses resulting from theft, because "Lombard was fully acquainted with the risks of continuing to invest with these marauders." (21a).

The court of appeals, while recognizing that "the parties agreed that GAM's actions with respect to the margin calls [of April, 1978] constituted a wrongful taking" and therefore satisfied that portion of the Connecticut larceny statute (6a), then substituted its own finding that the petitioner had failed to prove that GAM intended to deprive the petitioner of its property within the meaning of the Connecticut penal code. Noting that the Connecticut Penal Code defines "deprive" as either the withholding from another of his property permanently or for so extended a period or under such circumstances that the major portion of its economic value or benefit is lost to him, or disposing of the property in such manner or under such circumstances as to render it unlikely that an owner will recover such property, *Conn. Gen. Stat.* § 53a-118(a)(3) (West, 1985), the court of appeals substituted its own factual analysis of the testimony adduced at trial without any reference to

Rule 52(a) of the Federal Rules of Civil Procedure. The court of appeals found that petitioner had failed to prove GAM obtained $1.77 million in April and May of 1978 either with the requisite intent to permanently deprive Lombard of those funds or that Lombard's funds had been appropriated by GAM to its own use to cover up its own gross malfeasance. These findings of the court of appeals were completely at odds with the factual findings previously made by the District Court. Compare (8a-9a) with (20a-21a).

The court of appeals would not defer to the discretion of the district court and challenged the district court's findings that GAM "exaggerated the threat posed by the margin call" or "fabricated the extent of the margin call' (8a). The court of appeals challenged the findings of the district court notwithstanding the compelling testimony of Kenneth Stevenson, Jr., the GAM comptroller, who testified, as recognized by the court of appeals "that GAM was making daily trades of well over $1 million and even as high as $7 or $8 million on the Lombard Brothers account." (8a). The court of appeals was also compelled to acknowledge that Stevenson's testimony was verified by the GAM transaction ledger for the Lombard Brothers account in April, 1978. (8a). The most extreme example [recognized by the Court of Appeals] occurred on April 4, 1978 when one REPO transaction alone involved $11 million. (8a).

Notwithstanding, the Second Circuit's characterization of the exaggeration issue as "a red herring", the district court found, and the factual record reveals, that the transfer of $1.77 million dollars satisfied GAM's demands of April and May, 1978. The testimony of Anthony Lombard was uncontradicted that GAM had threatened the petitioner with a potential liability of $30-$40 million dollars if the demand for $1.77 million dollars was not met. If, indeed, state and federal regulatory agencies had discovered that GAM had obtained Lombard's funds through fraud and misrepresentation,

which would clearly have been revealed had the Lombards been unwilling or unable to meet GAM's demand for $1.77 million dollars in April and May, 1978, GAM and its principals would have faced civil and criminal liability.

Finally, the court of appeals disagreed with the district court's finding that GAM "acted with complete knowledge that the funds would be disposed of in such a manner that Lombard would never be able to recover them." (9a). The court of appeals drew the inference that the margin calls made further losses by Lombard unlikely (9a), where the district court had found that the margin calls were a device to cover up and conceal GAM's malfeasance. (21a). It is precisely because the court of appeals substituted its own findings of fact for those of the district court which had the opportunity to hear the witnesses at trial and evaluate the documentary evidence in light of the testimony that petitioner now seeks a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit.

## REASONS FOR GRANTING THE WRIT

### I. THE DECISION OF THE COURT BELOW IS ONE OF EXCEPTIONAL IMPORTANCE BECAUSE THE COURT OF APPEALS FAILED TO COMPLY WITH THE COMMAND OF RULE 52(a) OF THE FEDERAL RULES OF CIVIL PROCEDURE AND THE ESTABLISHED PRECEDENT OF THIS COURT INTERPRETING THAT RULE THAT THE FINDINGS OF FACT OF A DISTRICT COURT MAY NOT BE SET ASIDE UNLESS CLEARLY ERRONEOUS IN A CASE INVOLVING A SUBSTANTIAL ISSUE UNDER THE INTERNAL REVENUE CODE

The decision of the court of appeals conflicts directly with decisions of this Court interpreting Rule 52(a) of the Federal Rules of Civil Procedure. The district court made specific findings of fact that with respect to the

$1.77 million obtained by GAM from petitioner in April and May, 1978, GAM used false pretenses and devices, mainly the monthly reports, to prevent Lombard from recognizing that GAM had been borrowing on margin to make up for the fact that it had lost all of Lombard's money. (20a-21a). The district court found that:

> In this instance GAM wrongfully obtained Lombard's monies by misrepresenting both the existence and scope of prior losses and exaggerating the threat posed by the margin call. These funds were obtained without Lombard's knowing consent. Furthermore, GAM obtained these monies with the requisite intent to permanently deprive Lombard of them. By fabricating the extent of the margin call in order to induce Lombard to make additional transfers of funds, GAM appropriated Lombard's funds to its own use to cover up its own gross malfeasance and acted with complete knowledge that the funds would be disposed of in such a manner that Lombard would never be able to recover them. See Conn. Gen. Stat. 53a-118(a)(3). In this instance, GAM committed larceny. Therefore, Lombard is entitled to take a theft loss with respect to these funds." (20a-21a).

These factual findings were made by the District Court after hearing the testimony of Anthony Lombard, Joe Bartoli, Kenneth Stevenson, Jr., [who confessed to his and GAM's wrongdoing during the years in question], a certified public accountant called by the petitioner and after examination of more than 50 exhibits and certain stipulations entered into between the petitioner and the respondent during the course of the trial. In reversing the district court's judgment for the petitioner, the court of appeals substituted its own factual findings for those of the district court in direct contravention of the decisions of the United States Supreme Court in *Anderson v. City of Bessemer City*, 470 U.S. 564, 105 S.Ct. 1504, 84 L.Ed.2d 518 (1985); *Bose Corp. v. Consumers Union of United States, Inc.*, 466 U.S. 485, 104 S.Ct. 1949, 80 L.Ed.2d 502 (1984); *Pullman-*

*Standard v. Swint*, 456 U.S. 273, 102 S.Ct. 1781, 72 L.Ed.2d 66 (1982); *United States v. United States Gypsum Co.*, 333 U.S. 36, 68 S.Ct. 525 (1948).

In determining whether there was a theft loss in this case, the District Court correctly looked to the law of the State of Connecticut to determine whether there had been a theft as defined by Connecticut's larceny statute. (18a); *Bagur v. Commissioner*, 603 F.2d 491, 501 (5 Cir. 1979). In pertinent part, Connecticut defines larceny as follows:

> A person commits larceny when, with intent to deprive another of property or to appropriate the same to himself or a third person, he wrongfully takes, obtains or withholds such property from an owner. Larceny includes, but is not limited to: . . . (2) Obtaining property by false pretenses . . . (3) Obtaining property by false promise.

*Conn. Gen. Stat.* § 53a-119a. In *State v. Kurvin*, 186 Conn. 555, 568 (1982), *overruled on other grounds*, *State v. Avcollie*, 188 Conn. 555, 568, the Connecticut Supreme Court found that larceny requires both the intent to wrongfully obtain as well as the intent to retain the property of another. Both the petitioner and the respondent agreed in both the district court and the court of appeals that GAM had wrongfully obtained the petitioner's property. The second element, that of retention, requires, as the district court found, that one intend to deprive the owner of his property permanently. Connecticut defines the phrase "to deprive" as follows:

> (A) to withold it or cause it to be withheld from him permanently or for so extended a period or under such circumstances that the major portion of its economic value or benefit is lost to him, or (B) to dispose of the property in such manner or under such circumstances as to render it unlikely that an owner will recover such property.

*Conn. Gen. Stat.* § 53a-118(a)(3).

Thus petitioner was required to prove that GAM *intended* either (1) to withhold the funds permanently or for so long a period that they lost their economic value or (2) to dispose of the funds so as to make recovery unlikely. The district court found as a fact that GAM retained the $1.77 million dollars with the requisite intent to permanently deprive Lombard of them. (21a). The district court found that GAM fabricated the extent of the margin call in order to induce Lombard to make additional transfers of the funds and "in effect", appropriated Lombard's funds to its own use to cover up its own gross malfeasance and acted with the complete knowledge that the funds would be disposed of in such a manner that Lombard would never be able to recover them." (21a). "In this instance, GAM committed larcency" entitling Lombard to a theft loss deduction with respect to the $1.77 million dollars obtained by GAM in April and May, 1978. (21a).

The factual findings by the district court that GAM obtained the petitioner's funds with the requisite intent to permanently deprive petitioner of them and that GAM had appropriated Lombard's funds to its own use to cover up its own gross malfeasance while acting with complete knowledge that the funds would be disposed of in such a manner that Lombard would never be able to recover them were not clearly erroneous and were completely supported by the entire record upon which the district court's findings were made. The findings of "ultimate facts", such as intent are clearly within the province and discretion of the district court and entitled to deference under the clearly erroneous standard of Rule 52(a); *Pullman-Standard vs. Swint*, 456 U.S. 288, 286-287, 102 S.Ct. 1781, 1789 (1982); *Commissioner v. Duberstein*, 363 U.S. 278, 80 S.Ct. 1190, 4 L.Ed.2d 1218 (1960). "Treating issues of intent as factual matters for the trier of fact is commonplace." *Pullman-Standard v. Swint*, 456 U.S. at 288, 102 S.Ct. 1790. See also *Dayton Board of Education v. Brinkman*, 443 U.S. 526,

534, 99 S.Ct. 2971, 1977, 61 L.Ed.2d 720 (1979) where this Court held that intent was a factual issue subject to the clearly erroneous rule of Rule 52(a) in determining whether a racially segregated school system had been intentionally maintained.

In *Pullman-Standard*, this Court ruled that the question as to whether differential impact of a seniority system reflected an intent to discriminate on account of race in violation of Title VII was a pure question of fact subject to the clearly erroneous standards of review. Justice White ruled that Rule 52(a) "does not make exceptions or purport to exclude certain categories of factual findings from the obligation of a court of appeals to accept a district court's findings unless clearly erroneous." 456 U.S. at 287, 102 S.Ct. at 1789. And, in *Commissioner v. Duberstein*, this Court held that the principal criterion for identifying a gift under the Internal Revenue Code was the intent or motive of the donor—"one that inquires what the basic reason for his conduct was in fact." *Id.* 363 U.S. at 286, 80 S.Ct. at 1197. These issues were questions of fact subject to the clearly erroneous rule. *Pullman-Standard v. Swint*, 456 U.S. at 288, 102 S.Ct. at 1790.

Rule 52(a) does not permit the division of findings of fact into those that deal with "ultimate" and those that deal with "subsidiary" facts. *Id.* The district court's findings that GAM acted with the intent to permanently deprive petitioner of its property and that GAM appropriated the $1.77 million at issue to conceal its own malfeasance in such a manner that Lombard would never be able to recover those funds were findings clearly entitled to the deference accorded them under Rule 52(a).

A finding is clearly erroneous when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed; *United States v. United States Gypsum Co.,* 333 U.S. 364, 395, 68

S.Ct. 525, 542, 92 L.Ed. 746 (1948). This standard does not permit a reviewing court to reverse the finding of the trier of fact "simply because it is convinced that it would have decided the case differently"; *Anderson v. City of Bessemer City*, 470 U.S. 564, 573, 105 S.Ct. 1504, 1511 (1985). Under *Anderson* and *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 123, 89 S.Ct. 1562, 1576, 23 L.Ed.2d 129 (1969), appellate courts must bear in mind that their function is not to decide factual issues *de novo*.

In *Anderson v. City of Bessemer City*, Justice White set forth the following standard:

> If the district court's account of the evidence is plausible in light of the record viewed in its entirety, the court of appeals may not reverse it even though convinced that had it been sitting as the trier of fact, it would have weighed the evidence differently. Where there are two permissible views of the evi-ednce, the fact finder's choice between them cannot be clearly erroneous.

*Id.* 470 U.S. 564, 573-574, 105 S.Ct. 1504, 1511 (1985); *United States v. Yellow Cab Co.*, 338 U.S. 338, 342, 70 S.Ct. 177, 94 L.Ed. 150 (1949); see also *Inwood Laboratories, Inc. v. Ives Laboratories*, 456 U.S. 844, 102 S.Ct. 2182, 72 L.Ed. 2d 606 (1982).

Even though this Court has expressly ruled that the clearly erroneous standard applies to district court findings which do not rest on credibility determinations, but are based instead on physical or documentary evidence or inferences from other facts, see *Anderson v. City of Bessemer, supra*, 470 U.S. at 574, 105 S.Ct. at 1511-1512, Judge Daly clearly had before him live witnesses whose testimony, credibility and demeanor he was uniquely able to judge and to assess.

The trial of this case on the merits before the district court was "the main event" rather than "a tryout on the road" to the court of appeals. See *Wainwright v.*

*Sykes*, 433 U.S. 72, 90, 97 S.Ct. 2497, 2508, 53 L.Ed.2d 594 (1977).

When the district court found as a fact that GAM deliberately exaggerated the threat of $30-$40 million dollar losses if Lombard did not pay $1.77 million dollars during April and May of 1978, that finding was well supported in the evidence, since the payments of $1.77 million dollars actually satisfied whatever outstanding liability existed at that time. Taken together with the fact that GAM had deceived the petitioner each and every month through the device of a false monthly report from November, 1976 through July, 1978 when Stevenson wrote to the petitioner advising them that $2.3 million dollars in losses were to be "booked", the district court drew a logical and inexorable inference that GAM had exaggerated the potential loss to the Lombards to ensure that GAM would be able to cover up its own gross malfeasance and wrongdoing committed prior to April, 1978 —wrongdoing which was deliberately concealed and hidden from the petitioner. When the district court found that GAM acted with complete knowledge that the $1.77 million dollars would be disposed of in such a manner that Lombard would never be able to recover it, the district court made such a finding after hearing testimony and reviewing documentary evidence which was undisputed at trial that from November 1976 through July, 1978 GAM had consistently lied to and cheated the petitioner. GAM's own employee testified that GAM had lied to the petitioner through the device of monthly reports which were false, misleading and inaccurate. It was both logical and reasonable for the district court to conclude that GAM lied so consistently to the petitioner to cover up wrongdoing, malfeasance and unlawful practices which had gone on for each and every month for 17 months.

In reversing the judgment of the district court, the court of appeals violated Rule 52(a) and the established

precedent of this Court. In the absence of a constitutionally-based rule of independent review, see *Bose Corp. v. Consumers Union of U.S., Inc.*, 466 U.S. 485, 500, 104 S.Ct. 1949, 1959 (1984), which is not applicable to this case, the ultimate and subsidiary facts found by the district court must be upheld since they were not clearly erroneous. To disregard this established standard of review would diminish the legitimacy of the district courts in the eyes of litigants, multiply appeals by encouraging appellate retrial of some factual issues, needlessly reallocate judicial authority and disregard the public interest in the stability and judicial economy that would be promoted by recognizing that the trial court, not the appellate tribunal, should be the finder of the facts. See *Advisory Committee Note to 1985 Amendment of Subdivision (a) of Rule 52 of the Federal Rules of Civil Procedure.*

In this case the court of appeals has departed from the accepted and usual course of judicial proceedings and has decided a federal question in a way in conflict with applicable decisions of this Court.

## CONCLUSION

For all the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

ANDREW B. BOWMAN
1804 Post Road East
Westport, CT 06880
(203) 259-0599
*Counsel of Record*
*for Petitioner*

# APPENDICES

**APPENDIX A**

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

---

No. 296, Docket 89-6123

LOMBARD BROTHERS, INC.,
*Plaintiff-Appellee,*

v.

UNITED STATES OF AMERICA,
*Defendant-Appellant.*

---

Argued Oct. 19, 1989

Decided Jan. 19, 1990

---

Richard Farber, Tax Div., Dept. of Justice, Washington, D.C. (Shirley D. Peterson, Asst. Atty. Gen., Gary R. Allen, Nancy G. Morgan, Tax Div., Dept. of Justice, Washington, D.C., Stanley A. Twardy, Jr., U.S. Atty., New Haven, Conn., of counsel), for defendant-appellant.

Andrew B. Bowman, Westport, Conn., for plaintiff-appellee.

WINTER, Circuit Judge:

This case involves a taxpayer's claim that certain investment losses are deductible as theft losses under the Internal Revenue Code of 1954, 26 U.S.C. § 165(a) (1982) (now Internal Revenue Code of 1986) (collectively "Tax Code"), because the investment company making the investments on the taxpayer's behalf en-

gaged in highly speculative securities trades and made several material misrepresentations to the taxpayer about the value of its investment account. We conclude that the investment company's acts did not constitute larceny under Connecticut law and that the losses therefore are not deductible under Section 165(a). We therefore reverse.

## BACKGROUND

The plaintiff Lombard Brothers, Inc. is a Connecticut trucking corporation. In September 1976, George Quinion, Jr., president of General Asset Management Co., Inc. ("GAM"), a Connecticut investment firm, approached his college acquaintance Anthony Lombard, treasurer of Lombard Brothers, and encouraged him to allow GAM to manage Lombard Brothers' surplus cash. Quinion indicated that he could earn a ten percent return on that cash by investing in government securities, compared to the four or five percent it was then earning on certificates of deposit. That month, Lombard Brothers entered into an agreement with GAM that granted GAM complete discretion to invest funds deposited by Lombard Brothers in a custodian account. The initial deposit was $800,100.

The agreement authorized GAM "to manage the Assets and render investment advisory and other related services . . . [and] to make all decisions with respect to (i) the investment policies and (ii) the purchase, sale, and retention of particular securities." GAM agreed to provide monthly investment reports, including a list of all transactions made for Lombard Brothers' account and all securities and cash in the account. The agreement entitled GAM to a quarterly investment advisory fee of one-half of one percent of the asset value of Lombard Brothers' account. The last page of the agreement contained the following notation: "Contract restricted to U.S. Government obligations only until further notice in writing."

Although GAM appears literally to have complied with the restriction to investments in U.S. government securities (a fact not material to our disposition of this case), it adopted a highly risky investment strategy, including long and short sales of securities, repurchase agreements ("REPO's"), and reverse REPO's. To make matters worse, GAM made many of these investments on margin, thereby putting at risk an amount substantially larger than Lombard Brothers' investment. Substantial losses ensued. GAM's monthly statements to Lombard Brothers failed to report the losses fully, however, and thus overstated the book value of the account. Nevertheless, the riskiness of GAM's investment strategy should have been evident to Lombard Brothers from the outset, because the monthly statements indicated the risky nature of the trades. Moreover, the dollar volume of trades disclosed by the statements greatly exceeded the amounts invested, a clear indication that trades were being made on margin. Indeed, Anthony Lombard testified that he had become suspicious of GAM as early as the fall of 1976 because Lombard Brothers had failed to receive any checks. Although he also testified that he had at that time requested partial repayment of the invested funds, Lombard Brothers nevertheless allowed GAM to continue to manage the funds in the account.

By the spring of 1977, Lombard Brothers was openly expressing its displeasure with the account. In March, Quinion wrote to Joe Bartoli, Lombard Brothers' comptroller, to confirm an oral conversation in which Quinion had explained the GAM market strategy of attempting "to take advantage of even small movements in the market" and in which he had reminded Bartoli that he "never guaranteed . . . profits in this money game." In May 1977, GAM acknowledged that its investment strategy had yet to pay off and relieved Lombard Brothers of any obligation for management fees until the account began to reflect a profit.

Events had turned still worse by April 1978, and William Jones, the officer of GAM who managed the Lombard Brothers account, telephoned Anthony Lombard to notify him of a margin call. Jones informed Lombard that Lombard Brothers had to wire a substantial amount of funds to the custodian account by that afternoon or risk losing a much larger amount—perhaps some $40 million. At a specially called meeting, Lombard Brothers' board of directors voted to wire $850,000 to the custodian account. After yet more margin calls, it sent an additional $920,000. Thus, during April and May, Lombard Brothers deposited a total of $1.77 million in the custodian account in response to margin calls.

Hoping to recoup its losses, Lombard Brothers threw good money after bad in the ensuing months. A third set of deposits, from June 1978 through May 1979, totalled $901,794.12. Finally, in the spring of 1979, Lombard Brothers stopped investing with GAM. The bottom line was a loss of $2,952,894.12 on an investment of $3,471,894.12.

In late 1979, Lombard Brothers filed a civil action against GAM in Connecticut state court. However, after the suit was dismissed as against several New York parties for lack of personal jurisdiction, and, after learning that GAM and Quinion were essentially judgment proof, Lombard Brothers abandoned the action. Lombard Brothers never advised any law enforcement agency that it was the victim of larceny, embezzlement, robbery, or other theft-like act in connection with its relationship with GAM.

In its 1978 federal income tax return, Lombard Brothers claimed a short-term capital loss of $1,965,610.14 in connection with the GAM losses. It later filed an amended return for 1978 in which it claimed an entitlement to an increase in its total ordinary deductions of that same amount. The amended return did not set forth the reason for the increased deduction. Then, in 1981,

Lombard Brothers filed amended returns for 1976 and 1977, carrying back the net operating loss resulting from the GAM losses discovered in 1978. When the IRS disallowed the refunds claimed for 1976 and 1977, Lombard Brothers filed the present action in the District of Connecticut.

Applying the Connecticut penal code definition of "theft" to each of the claimed deductions, the district court found that GAM committed no theft in connection with Lombard Brothers' initial deposit of $800,100 or in connection with the third set of deposits totalling $901,794.12 from June 1978 through March 1979. However, with respect to the second set of deposits totalling $1.77 million made in response to the margin calls during April and May 1978, the district court found that, through its alleged omissions and misrepresentations, GAM had effectively "appropriated Lombard's funds to its own use to cover up its own gross malfeasance and acted with complete knowledge that the funds would be disposed of in such a manner that Lombard would never be able to recover them." Thus, the district court concluded that GAM had committed larceny under Connecticut law with regard to the specified funds and that Lombard Brothers was entitled to claim a theft loss of $1.77 million. The government appealed. We reverse.

## DISCUSSION

Section 165(a) of the Tax Code authorizes the deduction of "any loss sustained during the taxable year and not compensated for by insurance or otherwise." 26 U.S.C. § 165(a). The Section permits a deduction for, inter alia, losses resulting from theft. *See* 26 U.S.C. § 165(e). For purposes of Section 165, "theft" includes larceny, embezzlement, and robbery, *see* 26 C.F.R. § 1.165-8(d), as defined by the law of the state where the claimed loss occurred—in the instant matter, Connecticut. *See Bagur v. Commissioner*, 603 F.2d 491, 501 (5th Cir.

1979). Moreover, to gain the deduction, Lombard Brothers had the burden of proving by clear and convincing evidence that it was caused by larceny or similar criminal acts. *See Bonney v. Commissioner*, 247 F.2d 237, 239 (2d Cir.), *cert. denied*, 355 U.S. 906, 78 S.Ct. 333, 2 L.Ed.2d 261 (1957); *see also Helvering v. Leonard*, 310 U.S. 80, 85-86, 60 S.Ct. 780, 783-84, 84 L.Ed. 1087 (1940) (stating that taxpayer must establish by "clear and convincing proof" that local law supports his claim of nontaxability under federal law) (citing *Helvering v. Fitch*, 309 U.S. 149, 156, 60 S.Ct. 427, 430, 84 L.Ed. 665 (1940)).

In pertinent part, the Connecticut penal code defines larceny as follows:

> A person commits larceny when, with intent to deprive another of property or to appropriate the same to himself or a third person, he wrongfully takes, obtains or withholds such property from an owner.

Conn.Gen.Stat.Ann. § 53a-119 (West 1985). A finding of larceny under that statute requires the proof of: (1) the intent to deprive another of property, and (2) the wrongful taking, obtaining, or withholding of the property. *See State v. Kurvin*, 186 Conn. 555, 568, 442 A.2d 1327, 1332-33 (1982), *overruled on other grounds, State v. Avcollie*, 188 Conn. 626, 453 A.2d 418 (1982), *cert. denied*, 461 U.S. 928, 103 S.Ct. 2088, 77 L.Ed.2d 299 (1983).

The parties agree that GAM's actions with respect to the margin calls constituted a wrongful taking and therefore satisfied element (2). However, the government challenges the district court's finding of element (1), the "intent to deprive another of property." The Connecticut penal code defines "deprive" as follows:

> To "deprive" another of property means (A) to withhold it or cause it to be withheld from him per-

> manently or for so extended a period or under such circumstances that the major portion of its economic value or benefit is lost to him, or (B) to dispose of the property in such manner or under such circumstances as to render it unlikely that an owner will recover such property.

Conn.Gen.Stat.Ann. § 53a-118(a)(3) (West 1985). In order to prove an intent to deprive, therefore, Lombard Brothers had to show that GAM *intended* either: (1) to withhold the funds permanently or for so long a period that they lost their economic value, or (2) to dispose of the funds so as to make recovery unlikely. This is a criminal statute, and it is not enough to show that GAM may have disposed of the funds in a negligent way that made recovery unlikely. Rather, GAM's *intent* to make recovery unlikely by its disposition of the funds must be shown.

The district court found that GAM possessed the intent to deprive Lombard Brothers of the funds because it, GAM, had full knowledge of the riskiness of the additional investment. It thus stated:

> GAM wrongfully obtained [the $1.77 million in transfers] by misrepresenting both the existence and scope of prior losses and exaggerating the threat posed by the margin call. These funds were obtained without Lombard's knowing consent. Furthermore, GAM obtained these monies with the requisite intent to permanently deprive Lombard of them. By fabricating the extent of the margin call in order to induce Lombard to make additional transfers of funds, GAM, in effect, appropriated Lombard's funds to its own use to cover up its own gross malfesance and acted with complete knowledge that the funds would be disposed of in such a manner that Lombard would never be able to recover them.

We disagree. We believe Lombard Brothers failed to meet even a preponderance-of-evidence test on these issues.

First, the record is extremely murky with regard to whether GAM "exaggerat[ed] the threat posed by the margin call" or "fabricat[ed] the extent of the margin call." Lombard Brothers' witness appeared not to have a specific recollection of GAM's estimates of threatened losses. Anthony Lombard, who testified that GAM advised him of the threat of enormous losses, gave various description of the threat, ranging from "a considerable amount of money being in the millions, 10, 15, all kinds of figures" to "20, 30, many million more dollars" to "20, 30, 40 million." However, he never claimed that GAM had exaggerated. It is clear in the record, however, that the losses were potentially enormous. Kenneth Stevenson, Jr., the GAM accounting head who testified for Lombard Brothers, stated that GAM was making daily trades of well over $1 million and even as high as $7 or $8 million on the Lombard Brothers account. His testimony was verified by the GAM transaction ledger for the Lombard Brothers account in April 1978. The most extreme example occurred on April 4, 1978, when one REPO transaction alone involved $11 million. Such high daily volume could lead to enormous losses in the event of a failure to meet a margin call. Lombard Brothers has not designated any evidence to the contrary, its brief on appeal merely restating, without citation to the trial record or exhibits, the conclusions of the district court.

Second, the exaggeration issue is a red herring because the margin call could not have been intended "to cover up [GAM's] gross malfeasance." To the contrary, GAM's reporting of a potentially enormous loss was actually a dramatic confession of its malfeasance. Indeed, the greater the exaggeration, the more inculpatory the confession of malfeasance. As Anthony Lombard testified,

it was the margin call that revealed to Lombard Brothers the extent of the risk and of the losses to which it was exposed. To be sure, malfeasance occurred in the concealment of losses before April 1978, but the margin call at that time revealed rather than concealed the malfeasance.

Finally, we do not agree that GAM "acted with complete knowledge that the funds would be disposed of in such a manner that Lombard would never be able to recover them." Nor do we agree with the district court's implied finding that GAM intended to make further losses likely. There is no evidence that GAM intended that Lombard Brothers lose its funds. Instead, GAM was attempting at the time of the first margin call be prevent the loss of additional funds. Indeed, both parties agree that GAM and Lombard Brothers were in fact attempting to recoup the earlier losses the account had suffered, and Lombard Brothers can hardly deny that by this time they were fully apprised of the nature of GAM's trading. In fact, they deposited over $900,000 in the months following the $1.77 million in question. Moreover, because GAM had suspended Lombard Brothers' obligation to pay a management fee until the account showed a profit, GAM had no incentive to make deliberately unprofitable trades. Thus, although GAM's hopes for the continued investment may have been unrealistic, neither evidence nor logic supports the conclusion that GAM possessed the intent to make recovery unlikely.

Reversed.

## APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

---

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the ninteenth day of January, one thousand nine hundred and ninety.

---

Present: Hon. J. Edward Lumbard
Hon. Thomas J. Meskill
Hon. Ralph K. Winter
Circuit Judges,

---

89-6123

Lombard Brothers, Inc.,
*Plaintiff-Appellee,*

-v.-

United States of America,
*Defendant-Appellant.*

---

Appeal from the United States District Court
for the District of Connecticut

---

## MANDATE

This cause came on to be heard on the transcript of record from the United States District Court for the District of Connecticut, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the Judgment of said District Court be and it hereby is reversed in accordance with the opinion of this court with costs to be taxed against the appellee.

ELAINE B. GOLDSMITH
Clerk

By: /s/ Edward J. Guardaro
EDWARD J. GUARDARO
Deputy Clerk

Issued as Mandate: 2-13-90

## APPENDIX C

UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

---

Civil No. N-87-212 (TFGD)

LOMBARD BROS., INC.
*Plaintiff,*

v.

UNITED STATES OF AMERICA
*Defendant.*

---

## MEMORANDUM OF DECISION

Plaintiff, Lombard Bros., Inc., ("Lombard") is suing the defendant United States seeking partial refunds of taxes it paid in 1976 and 1977. Lombard's theory of recovery is predicated upon 26 U.S.C. 165(a) & (e), which provide that a taxpayer victimized by theft may claim as a deduction the resulting loss which remains uncompensated by insurance. The question to be resolved in this dispute is whether Lombard was victimized by theft or by simply its own imprudent involvement in a "get rich quick" investment scheme.

## FINDINGS OF FACT

Lombard is a Connecticut corporation which, during the events in question, operated its trucking business in Waterbury, Connecticut. In September 1976, Anthony Lombard, the plaintiff's treasurer, was approached by a college acquaintance and family friend, George Quinion, Jr., about investing plaintiff's surplus capital in a "cash management system." Quinion was president of General

Asset Management Co., Inc., ("GAM"). On September 13, 1976, plaintiff Lombard entered into a contract with GAM giving it the right to invest the funds Lombard had deposited in a custodian account established at GAM's direction. Pursuant to this contract Lombard granted GAM "full authority . . . to make all decisions with respect to (i) the investment policies and (ii) the purchase, sale, and retention of particular securities[ ]" with respect to funds deposited into the custodian account. This authority was limited, however, by certain language appended to the last page of the contract, which provided that the "[c]ontract [was] restricted to U.S. Governmet obligations only until further notice of writing."

Pursuant to this agreement, Lombard deposited the following amounts into its custodian account:

| AMOUNT | DATE |
|---|---|
| $800,100.00 | September, 1976 |
| $850,000.00 | April, 1978 |
| $920,000.00 | May, 1978 |
| $150,000.00 | June, 1978 |
| $5,000.00 | July, 1978 |
| $133,000.00 | January, 1979 |
| $595,000.00 | February, 1979 |
| $18,794.12 | March, 1979 |

Lombard received back from GAM the following amounts:

| AMOUNT | DATE |
|---|---|
| $254,000.00 | February, 1977 |
| $150,000.00 | October, 1977 |
| $100,000.00 | December, 1977 |
| $15,000.00 | June, 1978 |

During the four years in question, GAM obtained from plaintiff as part of its investment arrangement a total of $3,471,894.12. From this sum, $2,952,894.12 was lost as a result of the high-risk investment strategy utilized by GAM in managing Lombard's account.

Anthony Lombard had no investment experience and did not seek out any additional expert advice before getting Lombard's directors to approve the investment management contract with GAM. He testified that GAM represented to him that it would invest plaintiff Lombard's monies in safe government bonds to earn a return of ten percent. This understanding conforms, in part, with the annotation on the contract limiting GAM's investment authority. While noting that the return promised by GAM was higher than Lombard was currently receiving on its monies, Anthony Lombard believed that Lombard's investment with GAM was similar to investing in a certificate of deposit or a savings account and that the principal Lombard invested would not be put at risk. Evidence that this understanding was deliberately fostered by GAM is shown in GAM's March 14, 1977 letter to Lombard's bookkeeper which stated: "The risk of owning a treasury outright is that the U.S. Government declares bankruptcy. If this occurs, our worries will make any such loss irrelevant as our currency in circulation will be worthless anyway." [1] Pl. Exh. 7, at 2.

At Lombard's direction, GAM sent monthly statements to Lombard regarding the status of its accout and investments. These statements purported to set forth, *inter alia*, the net book value of the securities owned by Lombard, the net book value of purchased interest, the cash balance of the account, the total book value of the account, ad the net gain (loss) and interest earned (lost) on transactions closed during the prior month. These statements also disclosed that GAM was engaging in such speculative trades as repurchase agreements ("repos"), reverse repos, "long" and "short" sales of securities. In

---

[1] In this very same letter, George Quinion also stated that while GAM tried to earn profits for Lombard by "buying and selling to take advantage of even small movements in the market[] . . . [it] never guaranteed . . . profits in this money game[.]" Pl. Exh. 7, at 2.

addition to the transaction summaries discussed above, GAM appended to each report a computerized listing of all the trades it made in plaintiff's account in the prior month. These listings demonstrated that a great deal of activity was taking place in plaintiff's accounts. Confirming this, GAM's former comptroller, Kenneth Stevenson, testified that plaintiff's account was unique because the volume of trading therein was at least ten times greater than the trading volume of any other GAM account. For example, in May 1977, plaintiff had approximately $545,000.00 invested with GAM, yet GAM made daily trades ranging from $1,000,000 to $2,000,000.

Lombard, however, did not recognize that something was terribly amiss. Anthony Lombard testified that he only glanced at the monthly statements, if he saw them at all, and then forwarded them to his bookkeeper, Joseph Bartoli, so that the proper accounting entries concerning interest expenses and earnings could be made. Lacking any training or experience in the buying or selling of government securities, neither Bartoli nor Anthony Lombard knew the significance of the data contained in the monthly reports. This, too, was confirmed by Stevenson, who after meeting with Bartoli and Lombard in early 1978, concluded that they had no understanding of the trading that was taking place and recommended to his GAM superiors that plaintiff be fully apprised of both the nature and status of its account. Rather than investigating and inquiring about their account, plaintiff Lombard relied on GAM's apparent good faith and honesty, and its representations about how the account would be managed and invested.

This reliance was misplaced. The monthly reports were both deceptive and grossly inaccurate. They failed to accurately report the monthly losses plaintiff incurred in its investment account. GAM incurred staggering losses and then tried to hide them by waiting to offset them against future gains, which never materialized. For ex-

ample, for January 1977, GAM reported a monthly loss of $3,083.75 when in fact its trading strategy had caused the plaintiff to suffer losses of $108,474.38 in that month alone. In doing this, GAM misrepresented the true running balance of Lombard's total losses. For example, using GAM's false numbers through the month of May 1978, Lombard might have concluded that the running balance of its account was a net gain of $33,133.26, when in fact as of that time the account had net losses of $2,303,367.70. The reports also did not disclose that GAM had used plaintiff's money to invest on margin or, in other words, to borrow a far greater amount than plaintiff originally invested. They also misrepresented the book value of Lombard's account. For example, Stevenson testified that in May 1977, Lombard's account was entirely depleted, yet GAM reported its book value as $350,042.21.

Prior to April 1978, Lombard's suspicions were not unduly aroused by GAM's activities. At some point in the Fall of 1977 Anthony Lombard became concerned when plaintiff Lombard was not receiving checks for the interest it had reportedly earned. However, his fears were allayed when GAM paid out $254,000 in early 1977 from the principal of the account so that Lombard could purchase additional machinery. In April 1978, the bottom fell out when GAM called Anthony Lombard with news of a margin call, demanding an additional $850,000 by mid-day and threatening that the failure to come up with the money could result in losses to Lombard ranging from $40,000,000 to $60,000,000. Faced with this threat, over the next two months Lombard transferred $1,770,000 to its GAM investment account.

Finally aware that it had suffered substantial losses, on April 19, 1978 Lombard sent written notice to GAM that it was terminating its account. Seeking to recoup its losses, however, Lombard continued to invest in the same fashion with GAM's primary money manager and

trader, William Jones, and still continued to receive monthly reports from GAM itself. Though Lombard had purportedly terminated its reltationship with GAM, little changed and losses kept mounting. In July 1978, GAM notified Lombard that it was "booking" losses in the amount of $2,304,895.25, *i.e.*, it had finally decided to account for those losses realized but not yet reported to Lombard. Despite its new found awareness of the substantial risk involved, Lombard continued to deposit money, an additional $901,794.12, in the custodian account for Jones to manage in the hope that eventually "things would turn around." They never did. After an IRS audit in the Spring of 1979, Lombard became aware of the magnitude of its losses and did not invest any additional funds.

Lombard never advised any law enforcement officials that it believed it was a victim of theft or fraud. Rather, in the latter part of 1979, Lombard brought a civil action against GAM, its principals, various brokers and other parties. After a portion of that action was dismissed for lack of personal jurisdiction and after learning through discovery that GAM and its principals were judgment proof, Lombard elected not to proceed further with that civil remedy.

On its original 1978 federal income tax return Lombard claimed a short-term "capital interest loss" of $1,965,610.14 attributable to the losses of funds caused by GAM's securities trading. On September 5, 1979, Lombard filed an amended 1978 federal income tax return for 1978 claiming that it was entitled to an increase in its total ordinary deductions of $1,965,610.14. This amended return did not specify the reason for the increased deduction. On July 16, 1981, Lombard filed amended federal income tax returns for 1976 and 1977 claiming refunds of taxes paid for those years due as a result of carrybacks of net operating losses alleged to have resulted from theft losses discovered in 1978. Upon the

defendant's refusal to classify the losses as ordinary losses resulting from theft and to issue a refund, plaintiff brought this tax refund action.

## CONCLUSIONS OF LAW

Lombard, as the taxpayer, bears the burden of proof on both the issue of whether a tax refund is owed and the amount of such refund. *United States v. Janis*, 428 U.S. 433, 440 (1976); *McCrory Corp. v. United States*, 651 F.2d 828, 836 (2d Cir. 1981). A taxpayer is entitled to take as a deduction losses resulting from theft. 26 U.S.C. § 165(a), (e). While the absence of a conviction for a theft offense may indicate that a theft loss did not occur, *Thompson v. Commissioner*, 23 T.C.M. (CCH) 1193 (1964), "[w]ith or without a conviction, the factual existence of a theft is what brings § 165(e) into operation." *Vietzke v. Commissioner*, 37 T.C. 504, 510 (1961); *but cf. Price v. Commissioner*, 30 T.C.M. (CCH) 1405-3, 1411 (1971) (failure of taxpayer to obtain criminal conviction or seek criminal redress for alleged theft loss raises "grave doubts" about entitlement to refund). When the taxpayer can show that theft was the more probable cause of the loss as opposed to some other cause or when the reasonable inferences from the evidence point to theft, the taxpayer will be deemed to have met its burden of proof. *See Allen v. Commissioner*, 16 T.C. 163, 166 (1951). The determination of when a theft has occurred for purposes of 26 U.S.C. § 165(e) is made by looking to the law of the jurisdiction where the theft allegedly occurred, in this instance the State of Connecticut. *Bagur v. Commissioner*, 603 F.2d 491, 501 (5th Cir. 1979); *Frankel v. Commissioner*, T.C. Memo. 1988-1 (1988).

Theft includes, but is not limited to, larceny, embezzlement, and robbery. Tax Reg. § 1.1658(d). This action's focus is on whether a larceny occurred, as that term is defined by the Connecticut legislature. In Connecticut,

> A person commits larceny when, with *intent to deprive another of property* or to appropriate the same to himself or a third person, he wrongfully takes, obtains or withholds such property from an owner. Larceny includes, but is not limited to: . . . (2) Obtaining property by false pretenses. . . . (3) Obtaining property by false promise.

Conn. Gen. Stat. § 53a-119 (emphasis added). In *State v. Kurvin*, 186 Conn. 555, 568 (1982), *overruled on other grounds*, *State v. Avcollie*, 188 Conn. 626 (1982), the Connecticut Supreme Court noted that larceny requires both the intent to wrongfully obtain as well as the intent to retain the property of another. To wrongfully take the property of another, one must acquire it without excuse or color of right and without the knowing consent of the owner. *Id.* The second element, that of retention, requires that one intend to deprive the owner of his property permanently. *Id.* Bearing this out, the Connecticut legislature defined "to 'deprive' " as:

> (A) to withhold it or cause it to be withheld from him *permanently or for so extended a period or under such circumstances that the major portion of its economic value or benefit is lost to him*, or (B) to dispose of the property in such manner or under such circumstances *as to render it unlikely that an owner will recover such property*.

Conn. Gen. Stat. § 53a-118(a)(3) (emphasis added). Applying this analysis, the *Kurvin* court stated in dicta that a criminal defendant who took from and consumed another's heroin formed the requisite intent to deprive of another of her property. 186 Conn. at 568-69.

Lombard contends that GAM's fraudulent misrepresentations concerning the nature and status of Lombard's account and the extent of the realized losses constitutes larceny by false pretenses as well as larceny by false promise, thereby establishing the predicate for a

theft loss. The United States contends that no theft loss has been established because the evidence fails to demonstrate that GAM appropriated Lombard's funds for its own use or for the use of some third person or that GAM ever intend to deprive Lombard of its monies. Both parties are only partly correct.

In September 1976, Lombard deposited $800,100 in the custodian account for GAM to invest. GAM wrongfully obtained this money from Lombard by falsely promising that it would prudently invest in safe government securities, earn a return of ten percent, and never jeopardize the principal investment. With respect to this initial sum, however, GAM did not form the requisite specific intent to deprive or permanently retain the funds it obtained from Lombard. GAM's false promises, made to induce Lombard to invest, must be viewed separately from its intent to use or to dispose of the investment fisc. That GAM intended to engage in speculation, does not compel this Court to conclude that it intended to deprive Lombard of its initial investment. Implicit in the intent to deprive component of larceny's retention requirement *and* in the definition of "to deprive" is the fact that the intent to deprive is a lesser species, albeit still a criminal one, of the act of appropriating another's property to one's own or a third party's use. *Id.* at 568. Because there is no evidence that GAM intended to deprive or retain in some permanent fashion Lombard's initial investment, the crime of larceny was not committed.

In April and May of 1978, Lombard, responding to a margin call, poured another $1,770,000 into its custodian account at GAM's behest. Lombard took these steps to ward off the threat communicated by GAM that if the margin call were not met Lombard faced losing from $40,000,000 to $60,000,000. GAM's false pretenses and devices, namely the monthly reports, prevented Lombard from recognizing that GAM had been borrowing,

in Lombard's name, on margin to make up for the fact that it had lost all of Lombard's money. In this instance, GAM wrongfully obtained Lombard's monies by misrepresenting both the existence and scope of prior losses and exaggerating the threat posed by the margin call. These funds were obtained without Lombard's knowing consent. Furthermore, GAM obtained these monies with the requisite intent to permanently deprive Lombard of them. By fabricating the extent of the margin call in order to induce Lombard to make additional transfers of funds, GAM, in effect, appropriated Lombard's funds to its own use to cover up its own gross malfeasance and acted with complete knowledge that the funds would be disposed of in such a manner that Lombard would never be able to recover them. *See* Conn. Gen. Stat. 53a-118(a)(3). In this instance, GAM committed larceny. Therefore, Lombard is entitled to take a theft loss with respect to these funds.

In June and July 1978, and January, February, March 1979, Lombard invested an additional $901,794.12 with GAM's principal trader, William Jones. No larceny was committed with respect to the transfer of these funds. While Lombard may not have completely understood the entire magnitude of its losses up to this time, Anthony Lombard testified that he and the board of directors knew that there was a substantial risk associated with any further investments. He testified further, however, that because they had lost so much they decided to continue investing until such time as Lombard recouped its losses. Given this frank admission about Lombard's corporate state of mind as of June 1978, the Court cannot say that GAM or Jones wrongfully obtained this third set of money transfers. Based on its prior experiences, Lombard was fully acquainted with the risks of continuing to invest with these marauders. Therefore, it cannot now allege that it was a victim of theft in these transactions. *Cf. Thompson v. Commissioner*, 23 T.C.M. (CCH) 1193, 1205 (1964) (taxpayer

continuing to provide additional funds to another after initial investment consents to that person's disposition of funds).

Judgment shall enter in accordance with this decision for the plaintiff. In accord with its representations at the close of trial, the defendant shall recompute plaintiff's federal income taxes for 1976 and 1977 and make the appropriate refund.

SO ORDERED.

Dated at Bridgeport, Connecticut this — day of March, 1989.

/s/ T. F. Gilroy Daly
T. F. GILROY DALY
U.S.D.J.

## APPENDIX D

UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

---

Civil No. N-87-212 (TFGD)

LOMBARD BROS., INC.

v.

UNITED STATES OF AMERICA

---

## JUDGMENT

This action came on for trial before the Honorable T. F. Gilroy Daly, United States District Judge, and the issues having been duly tried and the Court having rendered its Memorandum of Decision as its Findings of Fact and Conclusions of Law,

It is ORDERED and ADJUDGED that judgment be and is hereby entered in favor of the plaintiff in accordance with the decision of the court and in accord with its representations at the close of trial, the defendant shall recompute plaintiff's federal income taxes for 1976 and 1977 and make the appropriate refund.

Dated at Bridgeport, Connecticut this 29th day of March, 1989.

KEVIN F. ROWE
Clerk

By /s/ Carol E. Cannady
CAROL E. CANNADY
Deputy in Charge